

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

MAR 25 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Bell Operating Company)

Provision of Out-of-Region)

Interstate, Interexchange Services)

CC Docket No. 96-21

DOCKET FILE COPY ORIGINAL

BELL ATLANTIC REPLY COMMENTS

Edward D. Young, III
Michael E. Glover
Of Counsel

Edward Shakin

1320 North Court House Road
Eighth Floor
Arlington, VA 22201
(703) 974-4864

Attorney for the
Bell Atlantic Telephone Companies
and Bell Atlantic Communications, Inc.

March 25, 1996

0-11

TABLE OF CONTENTS

Introduction and Summary	i
1. Bell Atlantic is Not a Dominant Provider of interLATA Services	2
2. There is No Danger of Cross Subsidy	4
3. There is No Danger of Discrimination	6
4. Do Not Place Added Burdens on Other Services	8
Conclusion	10

Introduction and Summary

The Commission must resist efforts by the long distance providers to shackle Bell Atlantic and other new entrants to the long distance business with a separate subsidiary requirement or other forms of excessive and burdensome regulation. The entry of Bell Atlantic and the other Bell operating companies is the key to bringing badly needed competition to long distance services. Congress recognized this need by authorizing the Bell operating companies to begin providing long distance service. The incumbent long distance carriers seek to game the regulatory process and advocate unnecessary regulatory burdens in order to disadvantage their new competitors. In order to promote fair competition, the Commission must allow Bell Atlantic and other newcomers to provide service under the same regulatory rules as the established long distance providers.

There can be no doubt that Bell Atlantic and the other Bell operating companies have “no ability to raise [long distance] prices by restricting output.” Indeed, none of the commenters offer any evidence that Bell operating companies can exert such control. As a result, according to the Commission’s own criteria, Bell Atlantic is entitled to be regulated as a nondominant provider of out-of-region long distance service.

Incumbent long distance companies nonetheless argue for costly and more burdensome separation requirements. In doing so, however, they fail to explain how Bell Atlantic and other companies could recover supposed cross subsidies in rates, or how such activities could have a real impact on such entrenched enterprises as AT&T and MCI. Thus, the proposed separate subsidiary requirements are unnecessary, and the additional separation requirements advocated by the incumbent long distance confederacy are simply competitive obstacles designed to hinder new market entrants.

Similarly, claims that Bell operating companies will use their local service to discriminate against other long distance providers ignore market realities. Even if sabotaging their own access service were possible, which it is not, it would unleash such a regulatory and customer backlash that the inescapable and substantial costs would make the theoretical benefits trivial in comparison.

The Commission should also reject arguments that it impose burdensome regulations that go beyond the limited issues raised in this docket. There is no basis for any separate subsidiary requirement here, much less a basis to extend such a requirement to other services or add other constraints to Bell Atlantic's ability to offer long distance service competition.

As explained in the attached reply affidavit of Dr. Robert W. Crandall, there is "no reason why the Commission should now develop its policies under the assumption that the BOCs will emulate the behavior of AT&T prior to 1982."¹ Because Bell Atlantic's and other Bell operating companies' provision of long distance service is "clearly pro-competitive,"² they should be allowed to provide service without arbitrary and unnecessary regulatory impediments.

¹ Reply Affidavit of Robert W. Crandall, ¶ 9 (attached) ("Crandall Reply").

² *Id.* at ¶ 3.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Bell Operating Company)	CC Docket No. 96-21
Provision of Out-of-Region)	
Interstate, Interexchange Services)	

BELL ATLANTIC REPLY COMMENTS

The Commission must resist efforts by the long distance incumbents to shackle Bell Atlantic and other new entrants with a separate subsidiary requirement or other forms of excessive and burdensome regulation. Excessive regulation would undermine the new competition authorized by the Telecommunications Act of 1996 before it even begins. There is no legitimate basis to impose such burdens. As Bell Atlantic explained in its initial comments, Bell Atlantic and other Bell operating companies enter the market as nondominant providers of interLATA services and there is no risk that they will, or can, impede competition.

In fact, as Congress recognized in its passage of the Telecommunications Act, entry of the Bell operating companies will interject much needed competition into the long distance market. According to Professor Paul W. MacAvoy, prices in the long distance market have converged to the point where AT&T's prices are virtually identical to its competition.³ The entry of Bell Atlantic and the other Bell operating companies is the key to breaking that cycle. As a result, the regulatory

³ Paul W. MacAvoy, "The Failure of Antitrust and Regulation to Establish Competition in Markets for Long-Distance Telephone Services," Yale School of Management Working Paper 44 at 95-96 (Nov. 1995). This convergence is so clear that recent price increases by *AT&T* have produced jumps in the stock prices of *MCI and Sprint*. *Id.* at 133-134.

requirements advocated by the incumbent long distance confederacy are not only unnecessary, they are affirmatively harmful.

The long distance incumbents argue that Bell Atlantic and other newcomers should be saddled with regulatory requirements that AT&T and every other long distance provider are spared. They argue that such disparate regulatory treatment is justified because of the newcomers' regulatory status as dominant carriers for local service. Their factual claims concerning the state of competition for local service miss changes in the marketplace however, and totally ignore the remaking of the local markets that is engendered by passage of the Act.⁴ Regardless, the state of *local* competition is irrelevant to the regulatory treatment of *long distance* services. This is doubly true in this docket, where the only services at issue are geographically separate from where the companies offer local service.

1. Bell Atlantic is Not a Dominant Provider of interLATA Services

As Bell Atlantic and other commenters explained in the initial comments,⁵ there can be no doubt that local telephone companies providing out-of-region long distance service have no "ability to raise [long distance] prices by restricting output."⁶ Indeed, none of the commenters offer any evidence that Bell operating companies can exert such control. As a result, according to the

⁴ For example, AT&T recently announced that it has filed to be a local service provider in all 50 states. AT&T Press Release, "AT&T completes initial steps to offer local phone service" (rel. Mar. 4, 1996).

⁵ *See, e.g.*, Comments of Bell Atlantic at 2-3, Ameritech at 2-5, SBC Communications, Inc. at 8-9 (filed Mar. 13, 1996).

⁶ *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 95 FCC 2d 554, 558 (1983) (quoting P. Areeda & D. Turner, Antitrust Law 322 (1978)).

Commission's own criteria, Bell Atlantic is entitled to be regulated as a nondominant provider of out-of-region long distance service.

AT&T argues that because the Commission has previously found there to be a single nationwide long distance market, Bell operating companies' out-of-region service must be considered jointly with their in-region long distance service and as a result, they should be considered dominant providers of long distance.⁷ In doing so, however, AT&T conveniently ignores the fact that the only issues in *this* proceeding is whether a Bell company providing out-of-region service could exercise market power in the nationwide long distance market. Even AT&T implicitly concedes it can not. Moreover, there are at least two reasons why focusing on the national market makes the case for nondominant treatment even stronger.

First, because in-region relief has not been granted yet, the *only* stand-alone long distance service currently authorized under the 1996 Act is out-of-region.⁸ Given Bell Atlantic and other companies' newcomer status, they should be considered nondominant regardless of the geographic size of the market. When evaluated on a national scale where large carriers like AT&T and MCI have already spent hundreds of millions to build nationwide recognition and loyalty for their long distance services, however, there can be no doubt that the newcomers are not dominant providers.

Second, even after Bell Atlantic is authorized to provide in-region service, it will still be a nondominant provider of long distance. If a market is defined as nationwide, Bell Atlantic is the

⁷ AT&T Comments at 4-5 (filed Mar. 13, 1996).

⁸ Bell Atlantic also is authorized to provide service in certain corridors connecting New Jersey with Pennsylvania and New York. But Bell Atlantic has no market power in its provision of this service and has a petition pending to be regulated as nondominant. *Petition to Regulate Bell Atlantic as a Nondominant Provider of Interstate interLATA Corridor Service*, DA 95-1666, Petition (filed July 7, 1995).

provider of local service to less than a seventh of that market, and initially will be the long distance provider to a negligible number of customers. Regardless of market definition, Bell Atlantic's local services will continue under price cap, equal access and other regulatory requirements that eliminate the ability to exercise market power in the long-distance market, even in its own region. Moreover, before Bell Atlantic will be authorized as a long distance provider in-region, it must first meet the legislative checklist that will assure that any lingering arguments of a local bottleneck have been put to rest.⁹ Thus, regardless of whether Bell Atlantic is authorized to provide in-region service, it should be considered a nondominant provider of long distance.

2. There is No Danger of Cross Subsidy

In its initial comments, and in the supporting affidavit of Dr. Robert Crandall, Bell Atlantic explained why cross subsidy and predation make no sense and are impossible for out-of-region long distance service providers.¹⁰ Among other reasons are the geographic separation of the services, the advent of price cap regulation and the inability to drive large competitors out of the market. Nothing in the opposing comments undercuts these fundamental points. While current long distance companies are expansive in arguing for costly and more burdensome separation requirements, they do not attempt to explain how Bell Atlantic and other companies could recover

⁹ See Act, § 151 (a), Part III, Sec. 271 (c)(2)(B).

¹⁰ Bell Atlantic Comments at 6-7, attached Affidavit of Robert W. Crandall, ¶¶ 7-10 ("Crandall Affidavit").

supposed cross subsidies in rates,¹¹ or how such activities could have a real impact on such entrenched enterprises as AT&T and MCI. Thus, the proposed separate subsidiary requirements are unnecessary, and the additional separation requirements advocated by the incumbent long distance confederacy¹² are simply competitive obstacles designed to hinder new market entrants.

MCI and AT&T go even further and argue that the cost allocation and accounting requirements imposed on regulated local exchange carriers (“LECs”) should be imposed on their long distance affiliates, even for costs that have no relation to LEC services.¹³ These alleged safeguards have nothing to do with preventing LEC cross subsidies. LECs are already under stringent cost allocation requirements for their own costs.¹⁴ To the extent a long distance service has any transaction that could impact LEC service costs, those amounts are strictly accounted for in accordance with existing rules. Regulating a long distance affiliate with the same stringent cost rules does nothing to add to such protection. Instead, it accounts for costs relating to transactions between long distance and other nonregulated nondominant services. There can be no danger of

¹¹ The Public Utilities Commission of Ohio (“PUC”) argues that its experience over “the last ten years” mandates specific separation requirements (p. 4) (comments filed Mar. 13, 1996). As Dr. Crandall explains in his attached reply affidavit, this view ignores changes in regulation over that same time period. Crandall Reply, ¶¶ 7-8. The FCC has moved to price caps with sharing, and more recently toward pure price caps. State regulators, including the Ohio PUC have made a similar evolution. In the current regulatory environment, it makes no sense to impose burdensome separate subsidiary requirements just to alleviate theoretical concerns that were never valid and have lost all pretense of legitimacy.

¹² *See, e.g.*, Comments of Excel Telecommunications, Inc. (“Excel”) at 6 (separate financial credit); Comments of the Telecommunications Resellers Association (“TRA”) at 21 (separate office space); Comments of Cable & Wireless, Inc. at 3 (separate personnel) (filed Mar. 13, 1996).

¹³ AT&T Comments at 8-9; Comments of MCI Telecommunications Corp. at 18-23 (filed Mar. 13, 1996).

¹⁴ In a world of pure price caps, where costs do not impact the level of regulated rates, those regulations are also unnecessary burdens. *See* Bell Atlantic Comments at 6-7.

abuse among services where there is no regulation of costs or prices. The Commission has previously rejected product specific cost allocation for nonregulated services.¹⁵ There can be no justification for imposing such a requirement here.

3. There is No Danger of Discrimination

In its initial comments, Bell Atlantic also explained why it is a fanciful error to claim that Bell Atlantic would somehow surreptitiously sabotage its own access service in order to gain a market advantage for long distance service.¹⁶ The parade of horrors concocted by the incumbent long distance confederation do not alter that analysis.

For example, TRA and Excel argue that Bell operating companies could limit access to signaling or network information, or delay provisioning service,¹⁷ but they fail to explain how the companies could do so consistent with existing Title II regulation of the LECs, or how they would avoid a market or regulatory backlash against their access services. Regardless, none of the regulatory burdens suggested by the long distance incumbents would address this supposed problem because they would require burdensome structural separation, but add nothing to the rules that already forbid unreasonable discrimination.

¹⁵ “It is not [the Commission’s] purpose, nor should it be [the Commission’s] purpose, to seek to attribute costs to particular nonregulated activities for purposes of establishing [sic] relationship between costs and price.” *Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities*, 2 FCC Rcd 1298, 1304 (1987).

¹⁶ Bell Atlantic Comments at 7-8; Crandall Affidavit. ¶ 11.

¹⁷ See Excel Comments at 4; TRA Comments at 14.

Similarly, AT&T and CompTel argue that LECs would use their local service to bully corporate customers into using affiliated long distance.¹⁸ But, as Dr. Crandall explains in his attached reply affidavit, such action would only serve to undermine the LECs competitive position in the local market and would not result in the type of customer loyalty needed to survive in this increasingly more competitive environment.¹⁹

The Commission also should reject efforts to prevent Bell Atlantic and other Bell operating companies from jointly marketing their various services to the extent authorized in the Act. Offering the option of packaged groups of services to customers is one of the benefits of new competition. After a transition period, the Act expressly allows joint marketing of long distance services with LEC services.²⁰ Joint marketing of various services will allow Bell Atlantic to compete on a more equal footing with full service providers such as AT&T, which plan to make “bundled offers like the industry has never seen before.”²¹ Indeed, the Commission has recently gone further and proposed allowing nondominant long distance carriers to bundle their transport service with customer premises equipment (“CPE”).²² The effort of the long distance incumbents to erect regulatory roadblocks in front of Bell Atlantic’s ability to jointly market its services is

¹⁸ Comments of the Competitive Telecommunications Assoc. (“CompTel”) at 4-5 (filed Mar. 13, 1996); AT&T Comments at 6.

¹⁹ *See* Crandall Reply, ¶ 6 (“[I]t would be folly for the BOCs to abuse their customers in this fashion”).

²⁰ Act, § 151, Part III, Sec. 272, (g)(2).

²¹ AT&T Chairman Robert E. Allen in AT&T News Release “AT&T’s Allen outlines plans to enter local telephone market” (rel. Feb. 8, 1996). According to Allen, AT&T will “offer business and consumers bundles of services that will combine local and long distance, wireless, on-line services, even television. As much or as little as the customer wants.”

²² *See* FCC News, “Commission Proposes That Long Distance Companies Be Relieved of Tariff Filing Requirement” (rel. March 21, 1996).

nothing more than an attempt to obtain a competitive advantage through the regulatory process.²³

This denies consumers the ability to choose and serves no one's interest but the incumbent providers.

4. Do Not Place Added Burdens on Other Services

While this docket was confined to the issue of interim regulation of out-of-region interLATA services, several commenters have argued for burdensome regulations that go beyond that limited issue. In addition to being procedurally flawed, the arguments for these additional burdens are substantively wrong.

For example, CompTel argues that Bell operating companies providing long distance service should not be allowed to complete collect calls, third-party billed calls or calling card calls to terminating numbers located within the companies local region until in-region relief has been granted.²⁴ This argument is directly contrary to the Act, which allows Bell companies to provide out-of-region long distance service immediately.²⁵ The only exception is 800 service or certain private line services.²⁶ But this exception only applies where the service allows "the

²³ There is no need in this docket to address the separate issue of use of customer proprietary network information, which the Commission has already indicated will be dealt with in a separate rulemaking "in the near future." *Amendment of the Commission's Rules to Establish New Personal Communications Services*, Order, GN Docket No. 90-314, DA 96-256, ¶ 9 (rel. Feb. 27, 1996).

²⁴ CompTel Comments at 13.

²⁵ Act, § 151 (a), Part III, Sec. 271 (b)(2).

²⁶ *Id.*, Sec. 271 (j).

called party to determine the interLATA carrier.”²⁷ None of the services listed by CompTel falls into this exception, and the general authorization in the Act must govern.

CompTel is also wrong to suggest that the restrictions proposed for out-of-region long distance should apply to incidental interLATA services such as those associated with commercial mobile services.²⁸ As Bell Atlantic has explained herein, those restrictions should not be imposed on out-of-region long distance, much less expanded to other services. While the Act does provide for temporary structural separation of certain incidental interLATA services associated with data retrieval, the remaining incidental interLATA services, including commercial mobile services, are specifically excluded from any separate subsidiary requirement.²⁹ Moreover, because the Commission has already determined that there is no need for burdensome Title II type regulation of cellular providers,³⁰ it would make no sense to impose

²⁷ *Id.*, Sec. 271(j)(2).

²⁸ CompTel Comments at 14. Vanguard Cellular Systems goes farther, and argues that Bell operating companies should not be allowed to provide long distance service to their in-region cellular customers, absent in-region relief (p. 8). Such an argument is inconsistent with the plain language of the Act which specifically allows immediate “interLATA provision by a Bell operating company or its affiliate” “of Commercial mobile services . . .” Act, § 151 (a), Part III, Secs. 271 (g) and 271 (g)(3). This clear understanding was recognized on the Senate floor and even AT&T has accepted this interpretation. *See* 142 Cong. Rec. S1311-03, (daily ed., Feb. 26, 1996) (quoting Sen. Breaux: “Upon enactment, the MFJ interLATA restriction on commercial mobile service affiliates of the Bell operating companies is eliminated.”); AT&T 1995 Annual Report at 25 (The Act permits “immediate RBOC provision of interexchange services...provided in conjunction with commercial mobile and cellular service.”).

²⁹ Act, § 151(a), Part III, Sec. 272 (a)(2)(B)(i).

³⁰ “Specifically, we will forbear from requiring or permitting tariffs for interstate service offered directly by CMRS providers to their customers.” In addition the Commission found that “because of the presence of competition in the CMRS market, access tariffs seem unnecessary.” **Implementation of Sections 3(n) and 332 of the Communications Act**, 9 FCC Rcd 1411, 1480 (1994).

the draconian dominant carrier regulation on a subset of such providers just because they now may provide long distance service as an incidental adjunct to their basic cellular service.

Finally, a few commenters argue that alliances or combinations among Bell operating companies requires greater scrutiny for their out-of-region long distance services.³¹ If any pair of regional Bell operating companies were to make a definitive agreement to provide long distance service jointly, the Commission would have the opportunity to study how such an agreement would impact implementation of the Act. Given that no such agreement currently exists,³² there is no basis for Commission action.

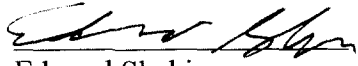
Conclusion

Based on the foregoing and Bell Atlantic's initial comments herein, the Commission should authorize Bell Atlantic and other Bell operating companies to be nondominant providers of out-of-region interLATA services without subjecting them to a separate subsidiary requirement.

³¹ **See** CompTel Comments at 12-13; Comments of the Association for Local Telecommunications Services at 5 (filed Mar. 13, 1996).

³² Affiliations relating to other services, including cellular, do not impact individual companies' lack of market power in the provision of long distance services and are therefore irrelevant to the issues before the Commission in this docket.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read 'Edward Shakin', written over a horizontal line.

Edward Shakin

Edward D. Young, III
Michael E. Glover
Of Counsel

1320 North Court House Road
Eighth Floor
Arlington, VA 22201
(703) 974-4864

Attorney for the
Bell Atlantic Telephone Companies
and Bell Atlantic Communications, Inc.

March 25, 1996

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC

In the matter of)	
)	
Bell Operating Company)	CC Docket 96-21
Provision of Out-of-Region)	
Interstate, Interexchange Service)	

Reply Affidavit of Robert W. Crandall

1. I am a Senior Fellow in Economic Studies at the Brookings Institution in Washington, DC.¹ My credentials and curriculum vitae were included in my original affidavit filed with the comments of Bell Atlantic in this matter on March 13, 1996. I have been asked by Bell Atlantic to respond to some of the concerns raised by other commenters in this proceeding.

Summary

2. A number of the commenters in this proceeding support the Commission's proposal to require that the Bell Operating Companies (BOCs) establish separate subsidiaries for their new out-of-region services. These commenters generally allege that there are two quite distinct dangers of allowing the BOCs to offer out-of-region interstate interexchange services as nondominant, integrated carriers, namely that: (I) the BOCs might use their in-region local-exchange facilities to discriminate against incoming interexchange traffic from other IX carriers

¹ These comments are solely those of the author and should not be construed to represent the views of the Brookings Institution, its other staff members, or Trustees.

and (ii) the BOCs might shift the costs of these out-of-region services to intrastate services.²

These commenters recommend that the Commission require the BOCs to establish separate subsidiaries for their out-of-region interstate IX operations, guarantee strict separation of personnel and facilities, and provide all in-region termination services to their out-of-region interexchange subsidiaries on an arms-length basis under tariff as preconditions for being granted nondominant status in offering interstate, interexchange services.

3. In this affidavit, I discuss both of these concerns, demonstrating that they are overstated and that they are already addressed by other means that are far less damaging to competition than the requirement of separate subsidiaries. In addition, given that the AT&T divestiture is now distant history and that the Modification of Final Judgment (MFJ) that settled the AT&T case has been vacated by the Telecommunications Act of 1996, I recommend that the burden of proof be placed squarely on those who propose onerous regulatory requirements. Since BOC entry into out-of-region interstate interexchange services is clearly pro-competitive, the BOCs should be allowed to proceed without unnecessary encumbrances unless there is clear evidence of actual anticompetitive abuse.

Discrimination

4. It bears repeating that the BOCs will enter the interstate interexchange market with a

² The Comments of AT&T, Sprint, MCI, The Telecommunications Resellers Association, Excel, The Competitive Telecommunications Association, and the Public Utilities Commission of Ohio raise one or both of these issues in various forms.

zero market share. Moreover, each one will compete with the other BOCs, the existing IX carriers, and other entrants for traffic in this market. As a result, each BOC is likely to account for a very small share of the incoming IX traffic that it terminates in its own region. Providing interexchange access for this incoming traffic is increasingly subject to competition from CAPs and, soon, from other new entrants into local telecommunications markets, including AT&T and MCI. It would be irrational for any BOC to discriminate selectively against the overwhelming share of its own interstate access business in order to attempt to build its very small share of interstate IX traffic.

5. There will likely be multiple new BOC entrants into out-of-region services. Each will be sending a small share of its own traffic for in-region termination and a large share in other BOC and LEC territories. The IX carriers and the other BOCs will have an excellent opportunity and every incentive to compare the quality of such termination services across the country. The Commission will obviously be able to share in this information and act on any evidence of abuses with dispatch. With such scrutiny and ample bases for comparison, it is unlikely that any discrimination that is sufficiently severe to disadvantage the IX carriers could escape detection.

6. More important, it simply strains credulity to suggest that the BOCs will succeed in the new more competitive order established by the Telecommunications Act of 1996 by using their in-region facilities to degrade the connections of, say, MCI or AT&T, to their large, in-region customers.³ The argument for such degradation requires the following strong assumptions:

³Comptel Comments at 4; AT&T Comments at 6.

- i. It assumes the BOCs still have an in-region bottleneck despite the fact that states now must allow competitive entry into intrastate services and the BOCs now must open their networks for interconnection by competitors;
- ii. It assumes that the BOCs can now identify the overwhelming share of calls delivered by other carriers from out-of-region locations;
- iii. It assumes that the BOCs will reduce the quality of termination services for all but the comparatively small share of calls that they originate out-of-region despite the fact that the termination of interstate calls provides a substantial share of the contribution to the fixed costs of the local loop;
- iv. It assumes that, after exercising this power to reduce service quality, the BOCs will then approach large in-region customers and demand that these customers switch to the BOCs own out-of-region interstate interexchange services or these customers will continue to receive low-quality in-region service;
- v. It assumes that, for some reason, these large companies will acquiesce to this extortion and will not seek out alternative carriers that are already available in urban corridors or new carriers as they become available; and

vi. It assumes that all of this will occur without detection by large sophisticated access customers, such as AT&T and MCI, and without detection by the regulators.

The abuse-of-dominance argument has now been replaced with an "abuse of customers" argument that is simply not credible. Now that there is entry into local telecommunications markets by large cable companies, such as Time Warner and Cablevision, and of large IX carriers, such as AT&T and MCI, it would be folly for the BOCs to abuse their customers in this fashion. It would only accelerate their loss of local market share.

Cross Subsidies

7. There is no doubt that carriers regulated on the basis of their costs and required to offer local services at rates far below an unconstrained monopoly price could attempt to shift costs from other activities into the regulated jurisdictions in order to convince their regulators of the need for higher regulated rates. Historically, this concern was addressed by scrutinizing the costs of regulated carriers to ensure that only those costs properly attributed to a service were reflected in the rates charged to customers for those services. These cost-allocation procedures were burdensome and imprecise. As a result, the Commission has recognized that there is a much better solution to this problem. After careful consideration, the Commission moved seven years ago to impose price caps on regulated interstate carriers (AT&T) while continuing to press for rate rebalancing and the development of competition in the interstate interexchange market. The next year, price caps were tentatively extended to the LECs' interstate activities, and in 1995 the Commission adopted a pure price-caps option that is stripped of any profit-sharing component.

8. For many years, the states steadfastly resisted any such approach to regulatory reform, apparently preferring monopoly and cost-based regulation to the more efficacious combination of price caps and competitive entry. As of 1994, only six states allowed competitive entry into the full array of local switched services, and only a handful of states had implemented even a partial price-cap regime. By 1995, the threat of Congressional action and perhaps the continuing demonstration effects of Commission action had induced another 10 states to allow entry into local services, but the majority of states still resisted the shift towards less-regulated competition.⁴ Obviously the Telecommunications Act of 1996 has now forced every state to open up its telecommunications markets to competition. As a result, the states are moving much more rapidly to implement price caps. Today, a majority of states either have implemented price caps or a local rate freeze, thereby ameliorating any legitimate concern over cross-subsidization. The other states still have the option of relying on cost-allocation procedures, but price-caps are clearly the superior mechanism for preventing cross-subsidies. Surely, the Commission should not hinder the development of competition in interstate markets through separate-subsidiary contrivances simply because some states are still resisting the most sensible course in this new era of open entry. Rather, the Commission should encourage states to move quickly to implement price caps and end the argument over cross subsidies.⁵

⁴ For a discussion of these trends, see Robert W. Crandall and Leonard Waverman, Talk is Cheap: The Promise of Telecommunications Reform in North America. Brookings, 1996, Chapter 2.

⁵ Some states still have profit-sharing in their price-cap regulations, thereby reducing their effectiveness in preventing cross-subsidization. The Commission has led by example and now should encourage the states to move towards "pure" price caps.

The Changed Policy Environment

9. The Telecommunications Act of 1996 has been enacted into law, and the MFJ has disappeared. There is no reason why the Commission should now develop its policies under the assumption that the BOCs will emulate the behavior of AT&T prior to 1982. The Telecommunications Act of 1996 provided for the immediate entry of the BOCs into these out-of-region markets and did not mandate structural separations for such operations. Imposition of onerous requirements on these out-of-region operations would surely slow the BOCs' entry into out-of-region interexchange services and would impose large costs on the BOCs, thereby reducing the strength of this new competition. These facts are obviously not lost on the IX companies filing comments in this proceeding.


10. None of the alleged problems in allowing the BOCs to operate as nondominant carriers in these out-of-region markets with unseparated facilities have yet surfaced. If they do, there will be ample opportunity for the Commission and, indeed, the antitrust authorities to respond. Any attempt to discriminate against other IX carriers or to cross-subsidize out-of-region services from in-region services would likely redound only slowly to the benefit of a BOC, if at all, but it would become apparent much more quickly to the BOC's customers, competitors, and regulators as well as to the antitrust authorities. However, the imposition of structural separations and the prohibition of joint ownership of in-region and out-of-region facilities would have immediate and adverse effects on potential competition.

11. Equally important is any attempt to prevent the BOCs from engaging in the joint marketing of in-region and out-of-region services, particularly to large customers. The IX carriers recognize the efficiencies available from such joint marketing, and they are therefore actively engaged in entering local telecommunications markets as facilities-based carriers or resellers. They clearly have an interest in preventing seven new competitors, now freed by Congress, from realizing similar economies. The Commission should not deny these new entrants the economies of joint marketing unless there is evidence of actual anticompetitive actions by the BOCs.

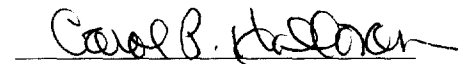
Conclusion

12. The BOCs should not be required to operate their out-of-region interexchange services from structurally separate subsidiaries, sacrificing joint operating and marketing economies, simply on the basis of speculation about potential anticompetitive conduct.

Further than this, affiant sayeth not.


Robert W. Crandall

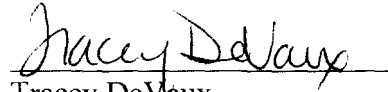
Subscribed and sworn before me this 22d day of March, 1996.


Notary Public

My commission expires:

CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of March, 1996 a copy of the foregoing "Bell Atlantic Reply Comments" was served on the parties on the attached list.


Tracey DeVaux

* Via hand delivery.